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Executive Secretary
E2-2869

THE DIRECTOR OF CENTRAL INTELLIGENCE

WASHINGTON, D.C. 20505

National Intelligence Council

DDI #2893-82
8 April 1982

MEMORANDUM FOR: Acting Director of Central Intelligence

FROM: [redacted]

25X1

Chairman, National Intelligence Council

SUBJECT:

The Soviet Bloc Financial Problem As a Source
of Western Influence

1. Attached is a paper on The Soviet Bloc Financial Problem As a Source of Western Influence prepared by [redacted] in response to a request from Hugh Montgomery, Director of Intelligence and Research, Department of State. As you will note in the Montgomery memo (Attachment 2), the paper was asked for by Secretary of State Haig so that he might have a better overview of the main themes of East-West economic issues.

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2. We have already forwarded the typescript of the paper to the Department of State and are in the process of releasing the paper as a NIC Memorandum.

3. This is a very good overview of this topic in my view. It is well worth reading.

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[redacted]

Attachments,
As stated

[redacted]
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DEPARTMENT OF STATE
 THE DIRECTOR OF INTELLIGENCE AND RESEARCH
 WASHINGTON

Lia. 3207-82

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March 16, 1982

MEMORANDUM FOR: [redacted]

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Chairman
 National Intelligence Council

SUBJECT : Paper on East-West Economic Issues

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I would be very grateful for your assistance on a project of some urgency which the Secretary has requested; specifically, he has asked for an overview of the main themes of East-West economic issues, and the direction in which they are heading. Essentially, he would like to examine the following topics:

A. The extent of Eastern European financial solvency, its ability to meet both interest and debt repayment schedules, and the implications of default by any one of the countries with current problems (Poland, Hungary and Romania, for example);

B. The degree to which Western European businesses are "dependent upon" their Eastern trading partners; put another way, to what extent would a significant slackening of trade between the East and West impact upon the economies of Western Europe, Germany in particular?

C. An examination of the role of credit, and the political leverage afforded by credit; how badly does Eastern Europe need additional credits, and to what extent can their being granted or withheld be translated into political pressures on such subjects, say, as Afghanistan?

D. How effective would a joint economic policy with our Western European allies be in the full panoply of relations with Eastern Europe? Should we attempt to introduce the shadings of differentiation into such discussions, and if so, to what end?

These points represent a tall order, and I realize that it will not be possible to do much more than an overall look-see at the basic issues and related considerations, but I would like to have something in hand for the Secretary no later than mid-April, if at all possible.

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The thought occurs that perhaps [redacted] if his other responsibilities permit, would be an ideal choice to supervise the preparation of such a paper, knowing that any product under his imprimatur would be a masterful effort. Would you please let me know at your convenience if you can assist with this problem, and if you require any additional input from us? Many thanks for your help and contribution on this important topic.

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24-
Hugh Montgomery

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The Reliability of East Europe's Trade Figures

By ANDRZEJ BLASZCZYNSKI

Jan Vanous and Michael Marrese in a recent article on this page ("Soviet Subsidies to Eastern Economies," Jan. 15) pick up on a very old debate: Does the Soviet Union reap the full benefits of empire in Eastern Europe including economic exploitation? Or, does it instead have to bear a considerable economic burden for the sake of mostly military and strategic benefits of hegemony in the area? Based on their own and others' research, Messrs. Vanous and Marrese side with the second position.

Their argument runs as follows:

The proponents of the "exploitationist" description of Soviet policy in Poland and the rest of Eastern Europe" have been unable to substantiate their assertions with sufficiently reliable evidence. Moreover, the evidence that does exist (official East European statistics) clearly demonstrates that contrary to popular wisdom the Soviets subsidize East European economies. This subsidy arises primarily from the combined factors of a price setting formula used for intra-bloc trade, the structure of that trade and alternative trade opportunities with the West. In addition, the Soviet Union is known to have provided sizable loans (for example, Soviet loans to Poland in the 1980-81 period were \$8 billion in hard currency and \$2.7 billion in ruble credits).

Furthermore, in Messrs. Vanous' and Marrese's conception these subsidies and loans are somewhat akin to bribes intended

"to sustain the allegiance of and maintain dominance over the Communist parties of Eastern Europe." The Soviets in turn reap the obvious military and strategic benefits as well as some minor political and economic benefits, including "even the support and friendship of certain segments of the East European population."

As a student of Soviet-East European economic relations I wish to express some reservations about this line of reasoning. The major issues center around the problems of evidence (of Soviet exploitation or subsidization) and motivation. In regards to the authors' explanation of Soviet motivation, one should recognize that it implies the Communist parties of Eastern Europe possess sufficient domestically derived power so that they must be bribed by Moscow rather than simply ordered. Their allegiance must be bought with subsidies. The fact of the matter is that in most of the East European countries and especially Poland the indigenous Communist parties could not survive in power more than a moment were it not for the threat of Soviet military action. This tends to produce extremely servile attitudes among East European rulers. Economic bribes are not necessary.

From Messrs. Vanous and Marrese's

statement about the "support and friend-

ship of certain segments of the East Euro-

pean population" one can infer that the

East European Communists could have

traded Soviet economic aid for domestic

political support. One can only guess what

the extent the Communists in Eastern Europe, "The Soviets in turn reap the benefits of trade with the USSR, these claims were as a rule not believed—rightly or wrongly. And, when the Communists had their backs to the wall, they openly waved the Red Army boneye in front of their subjects to 'keep' them in line. That is the only argument I wish to express some- ment that works and the only source of the Communists' sovereignty."

What of the evidence about intra-bloc trade? The evidence offered by those who claim the USSR exploits its East European trading partners is indeed sometimes hawed and always fragmented. Most of it consists of personal accounts of unfair arrangements in specific industries or products. For obvious reasons it cannot be verified. Moreover, these individual fragments are not sufficient to assemble into an overall accounting of the gains or losses from trade according to the trading countries. A more exhaustive accounting appears in the official East European published statistics. The question is: Are these statistics any more reliable? Can these official statistics be verified? Absolutely not. One is not likely to be able to spot-check the quality, quantity or reality of goods found to be fairly consistent (though not without some discrepancies), and it was assumed that an international conspiracy to doctor the numbers was not possible. But consistency does not prove verifiability, and it doesn't take too much imagination to devise a scheme for assuring consistency among several central statistical agencies without even involving excessive numbers of statisticians and bureaucrats.

One final comment on the Soviet loans to Poland. To the extent they were granted in the form of hard currency, they can presumably be verified when spent in the West. The matter of ruble credits is more complicated. Rubles are not readily convertible into commodities nor other currencies. Without the Soviet central planning agency specifically earmarking the production of items desired by the loan recipient, ruble credits are meaningless. In Soviet-type economies only the stuff that moves in boxes and barrels really matters. And, no one can verify any purely intra-Soviet bloc transactions anyway—be they on paper or in crates.

Mr. Blaszczynski is assistant professor of economics at Central Connecticut State College.

COMMUNISTS

Soviet Imperialism Is in the Red

As European colonial powers learned long ago, an empire can be expensive. The present-day Soviet version certainly is. And the costs have been climbing steeply, to the point where the Russians have started to complain aloud. In a recent blistering letter to the Polish Central Committee, the Soviet Central Committee growled about "slanderers and liars" who say the Soviet Union is "plundering" the Poles, when in fact it "is provisioning the main branches of Polish industry" with subsidized fuel and materials.

The chart on this page traces the leaping rise in the principal component of the Soviet empire's cost: the trade subsidy extended to the East European satellites—Poland, East Germany, Czechoslovakia, Hungary, Rumania, Bulgaria. In the early years after World War II, the flow ran the other way. Research done by Paul Marer, a top Soviet-bloc specialist who teaches at Indiana University, indicates that in the later 1940s the Russians removed—that is, looted—about \$14 billion worth of machinery and other goods from Eastern Europe, an amount roughly equal to what the U.S. poured into Western Europe during those same years through the Marshall Plan.

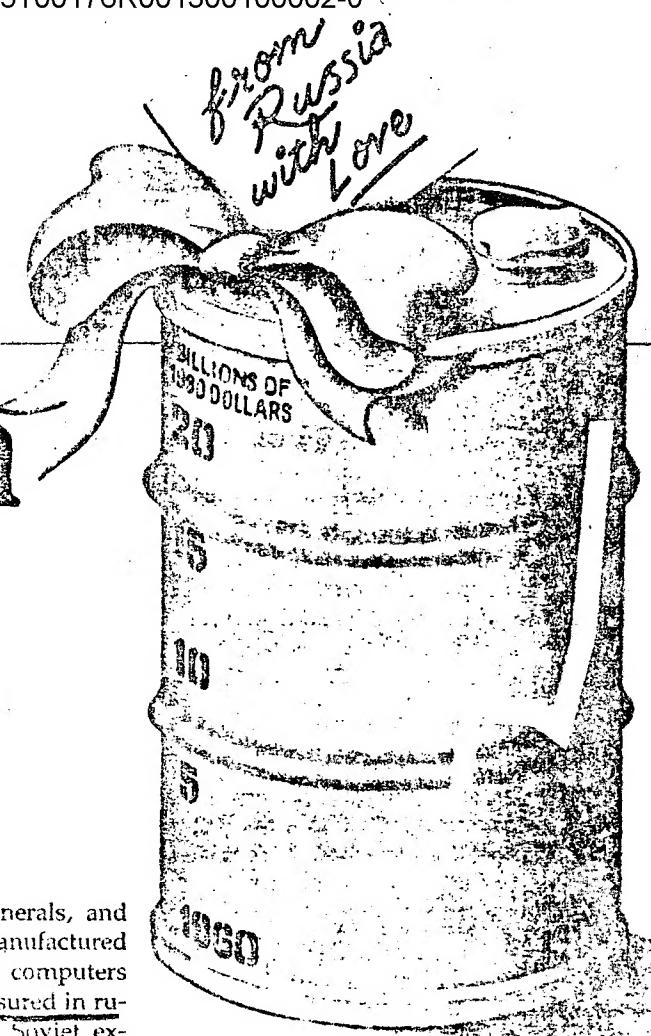
After a while, the Soviet Union imposed a trading pattern designed to link the economies of the satellites to that of the Imperium. The Russians send their

satellites oil, natural gas, minerals, and cotton in exchange for manufactured goods such as East German computers and Hungarian buses. As measured in ruble value, nearly 64% of the Soviet exports to Eastern Europe in 1978 consisted of raw materials; and of Soviet imports from Eastern Europe that year, 78% consisted of machinery and equipment, along with manufactured consumer goods.

The nook that helps ensure the satellites' fidelity is that the Russians sell their fuel and raw materials at less than world-market prices. For the Soviet Union, these trade subsidies constitute what economists call an opportunity cost. That is, the Russians are forgoing an opportunity to earn more money by, say, selling their oil in Rotterdam rather than in Prague. It's quite a cost, amounting on some estimates to more than \$20 billion last year. The Russians also prop up the economies of their satellites through other means, including direct grants-in-aid, low-interest loans, and commercial credits.

A sweet deal for Castro

It might seem that the Russians incur a continuing military cost to keep their satellites from breaking away—as most of them, no doubt, would do if they could. But Western experts point out that a Soviet Union without its East European buffer would probably spend even more than



The Empire Strikes Back

The Soviet Union props up the economies of its satellites by selling oil and minerals at less than world-market prices. Oil accounts for a large part of the total subsidy. The cost to the Soviet Union took off in two great surges in the Seventies, as the prices Moscow was charging the satellites lagged behind the OPEC run-ups of 1973-74 and 1979. The chart figures come from a study by economists Jan Vanous and Michael Marrese, respected authorities on Soviet-bloc trade. Under an arrangement adopted in 1975, East-bloc prices are adjusted annually on the basis of a five-year moving average of world prices. Thus if the world price of oil declines in years ahead, or increases less rapidly than other prices, the Soviet subsidy will shrink.

The Russians have begun to demand hard currency for weapons sent to oil-rich countries like Libya.

the current awesome amount for defense, since in the Russian view more hardware would be needed to secure the country's borders. A military invasion of Poland, however, would be an expensive undertaking. Aside from the costs of the invasion itself, the Russians would have to try to get a collapsed economy functioning with a surly if not rebellious labor force, and they might well find themselves held accountable for Poland's \$23-billion debt to Western banks and governments.

The rise in Moscow's financial burden has been the result of three factors. First, the world prices of raw materials—especially oil—have gone up faster than the discount prices Moscow has charged its satellites. Second, some of the satellites are in dire economic trouble—Poland and, to a lesser extent, Czechoslovakia—and the Russians have had to help bail out these faltering dependents.

And finally, the empire itself has been expanding—Cuba, Vietnam, some would now include Afghanistan. Cuba has been an especially costly satellite. According to Fidel Castro, in a December 1979 speech, the Russians were going to sell Havana 11.1 million metric tons of petroleum and refined products in 1980 at an estimated crude-oil-equivalent price of \$12.80 per barrel, vs. the world-market price of about \$35. The implied opportunity cost to Moscow for the year works out to \$1.8 billion.

Even Vietnamese vodka

Unlike the Eastern Europeans, who pay for Soviet oil with manufactured goods and some hard currency, the Cubans pay with sugar and nickel. Moreover, the prices of this sugar and nickel are linked to the prices Moscow charges Havana for oil. Thus the Cubans are assured that oil-price hikes won't make any difference to them whatsoever. Since the Soviet Union is itself the world's largest producer of both sugar and nickel, there is really no doubt that this trade pattern is designed to prop up the Cuban economy.

Vietnam's new trade relationship with the Soviet Union is much like Cuba's. In

return for raw materials, the Vietnamese send the Soviet Union consumer goods, including clothing, carpets, handicrafts, and some food, as well as rubber and rubber products. The Soviet Union even imports Vietnamese vodka; it's believed the stuff is used for domestic Soviet consumption, thus freeing Russian vodka for export to hard-currency markets. The U.S. State Department estimates that the current annual cost to the Soviet Union of its new Indochina satellite comes to about \$1.1 billion.

Happily for the Russians, the rising costs of empire in the last few years have been extensively offset by three financial windfalls. As the world price of oil went up, the Russians made a hard-currency killing even though they have frozen oil exports to the West at about 1.3 million barrels a day. In 1975 oil exports earned the Russians \$4 billion; in 1979 the same volume of exports brought in \$9.5 billion. And as the world's second-largest producer of gold, the Soviet Union has scored big by making occasional sales to Western buyers. Finally, the Russians have begun to demand hard currency for weapons sent to oil-rich countries like Libya; Moscow used to give weapons away.

What's more, the Soviet Union does enjoy some financial pluses from its empire. Czechoslovakia is now pouring an astounding 30% of its new investment into a nuclear-power program designed to serve the entire region; what the Czechs spend on research and development, the Russians save. And in return for their oil the Russians do receive large volumes of manufactured goods that are superior to anything they themselves produce.

This hasn't stopped Russians from complaining that the goods they get from the satellites are of lower quality than Western goods—which the Russians could afford, they point out, if they sold their oil for hard currency. But some Western experts have concluded that the Russians are getting goods at prices lower than they would have to pay in the West. If this is true—and not all experts believe it is—then in a sense the Russians are re-

ceiving a subsidy from their satellites.

Still, there's no doubt the empire is costing the Russians a pretty kopek. And this comes in addition to the many billions of rubles Moscow spends to project its power into countries like South Yemen, Ethiopia, and Angola. Since these countries aren't part of the empire proper—at least not yet—the money Moscow spends can be regarded as economic and military aid in the traditional big-power sense.

Economically, then, the empire is a losing proposition, but its value to the Soviet Union transcends balance-sheet terms. The geographic and ideological buffer between the Soviet Union's western border and the Free World is immensely valuable in the eyes of Kremlin leaders. Cuba provides an unsinkable aircraft carrier just 90 miles off the Florida coast, and presumably the services of those 35,000 Cuban troops in Africa are worth a lot to Moscow. Vietnam humiliated the U.S.—no way to put a dollar, or ruble, value on that—and today Vietnamese soldiers, like their Cuban and East German comrades, are serving as effective surrogates for the Russians.

The fatal error of avarice

Imperial powers have always incurred financial costs in return for the non-financial benefits of empire. In the heydays of the British and French empires, debates went on incessantly over whether the empires were worth the financial cost. All the debates came down to the same point. Empires are not meant to be economic structures, hence their value can't be measured in economic terms. In 1933 the French historian and champion of colonization Gabriel Hanotaux summed the matter up like this: "Let us get away from the fatal error of base and immoderate avarice that demands, 'How much does colonization pay?' From it comes an embellishment of living, an enlargement of inspirational force: the Empire."

This isn't exactly the way Kremlin leaders phrase it. But there's no evidence whatsoever that they have any doubt the empire is worth its rising cost.